

STATE OF CALIFORNIA

Public Utilities Commission  
San Francisco

**M e m o r a n d u m**

**Date:** April 5, 2006

**To:** The Commission  
(Meeting of April 13, 2006)

**From:** Delaney Hunter, Director  
Office of Governmental Affairs (OGA) — Sacramento

**Subject:** **SB 1833 (Kehoe) - Electrical restructuring: energy prices paid to non-utility generators.**  
**As Introduced February 24, 2006**

**LEGISLATIVE SUBCOMMITTEE RECOMMENDATION:** Support (*CPUC Sponsored bill*).

**SUMMARY OF BILL:**

This bill would repeal Public Utilities Code Section 390, which establishes the methodology for determining the short run avoided cost ("SRAC") energy payments by utilities to qualifying facilities ("QFs").

**DIVISION ANALYSIS (Energy/Legal Division):**

Public Utilities Code Section 390 ("Section 390") was adopted as part of AB 1890, California's electric industry restructuring law of 1996. Among other things, it established the methodology for determining the short run avoided cost ("SRAC") energy payments by utilities to qualifying facilities ("QF's"). Under Section 390, SRAC energy payments would be based on the clearing price paid by an independent Power Exchange ("PX") once that entity was deemed to be functioning properly. Until that time, SRAC energy payments would be based on a "transitional" formula which was tied to California natural gas border price indices. However, in January 2001, the PX ceased to exist, and the "interim" formula, anticipated to be in place for 14 months became the permanent methodology for calculating SRAC energy prices.

Southern California Edison Company and various QF parties have challenged Commission decisions on two separate occasions concerning the Section 390 transitional formula on the grounds that the formula violates PURPA. In both instances, the Court of Appeal, Second Appellate District, has upheld the Commission's decisions.

However, in *Southern California Edison Co. v. Public Utilities Comm.* (2002) 101 Cal. App. 4<sup>th</sup> 982, the Court referred to Section 390 as a “millstone around the Commission’s neck.”

Although the Courts have upheld the Commission’s implementation of Section 390 as consistent with PURPA, we believe the existence of Section 390 leaves the Commission vulnerable to further litigation. Further, Section 390 is inconsistent with the Commission’s other methodologies for determining market prices and restricts the means by which a “proper” avoided cost may be developed in the Commission’s current proceeding on this issue, R.04-04-025.

## **PROGRAM BACKGROUND:**

The Public Utility Regulatory Policies Act (“PURPA”) was enacted in 1978 to encourage competition in the power generation market through the creation of a class of non-utility co-generation and small power production facilities known as qualifying facilities (“QF’s”). Section 210 of PURPA directs the Federal Energy Regulatory Commission (“FERC”) to implement the legislation requiring public utilities under state regulation to purchase electricity from QF’s at prices set by avoided cost. (16 U.S.C. § 824a-3(a).) Avoided cost is the cost the utility would otherwise pay to generate or buy power from another source. (18 C.F.R. §292.101(b)(6).) However, PURPA leaves the determination of avoided cost to state regulatory commissions. (18 C.F.R. §§ 292.301-292.304.)

Avoided cost is intended to reflect the cost the utility would otherwise pay to generate or buy power, **not** the QF’s actual cost. Prior to 1996, the Commission adopted an “index” methodology as a proxy for avoided cost. (*Re Implementation of Biennial Resource Plan Update* [D.96-12-028] (1996) 69 Cal.P.U.C.2d 546, 548-549.) This methodology had been revised numerous times over the years, including modifications to the specific components. (*Id.* at p. 549.) In 1996, as part of the legislation for restructuring California’s electric industry (Assembly Bill 1890, Stats. 1996, Ch. 854), the Legislature enacted Section 390. Under Section 390, SRAC energy payments would be based on the clearing price paid by an independent PX, once that entity was deemed to be functioning properly. (Pub. Util. Code § 390(c).) Until such time, SRAC energy payments would be based on a formula tied to California gas border price indices. (Pub. Util. Code § 390(b).)<sup>1</sup>

Pursuant to Section 390(b), the Commission issued D.96-12-028, which replaced the then prevailing index methodology with an interim transition formula (“Transition Formula”). The Transition Formula included a utility-specific “factor” which was designed to relate SRAC prices to gas border prices for each utility. The gas prices for Edison and SDG&E were based on the Topock index, while the prices for PG&E were

based on a weighted index of 50% Topock and 50% Malin.<sup>1</sup> At the time this decision was adopted, it was anticipated that the PX would be properly functioning in approximately 14 months. On July 28, 2000, Edison filed a petition to modify one component, the fixed factor, of its Transition Formula. Edison claimed that because of lower intrastate transportation costs, the relationship of its avoided costs and gas border prices was no longer reflected in the fixed factor. In its comments to Edison's petition, the Office of Ratepayer Advocates (ORA) recommended that the Commission also review the gas border price indices used in the Transition Formula. ORA asserted that the Transition Formula should not use the Topock index in the Transition Formula as it believed that Topock was no longer robust. In March 2001, the Commission issued D.01-03-067. Among other things, D.01-03-067 modified the Transition Formula by: 1) replacing Edison's fixed factor with a dynamic factor based on a formula and 2) replacing the Topock index with the Malin index for all three utilities. This "Modified Formula" is currently being used to calculate SRAC energy payments. Edison and several QF parties sought court review of D.01-03-067, as affirmed in D.01-12-028 and D.02-02-028, arguing, among other things, that the Modified Formula violated PURPA. In *Southern California Edison Co. v. Public Utilities Comm.* (2002) 101 Cal. App. 4<sup>th</sup> 982, the Second Appellate District upheld the Commission's decisions. However, the Court noted that: "While not a basis for this decision, it is apparent that the Legislature needs to reexamine section 390. In its present form, section 390 acts as a millstone around the Commission's neck." (*Id.* at p. 991, fn. 15.)

In December 2003, the Commission issued D.03-12-062, as modified by D.04-07-037. In that decision, the Commission expressed a concern with the Section 390 formula. It noted:

"The current SRAC formula was considered and adopted in D.01-03-067 and D.02-02-028, and this formula was upheld [. . .]. (*Southern California Edison Co. v. Public Utilities Comm.* (2002) 101 Cal. App. 4<sup>th</sup> 982.)

The concern exists, however, that the SRAC pricing formula may need to be revised in light of the current energy market. Therefore, the Commission should carefully consider how to modify the SRAC methodology and whether to seek legislative changes to Pub. Util. Code section 390. Because it is important that current methodologies to establish SRAC be critically evaluated and modified where necessary, we are directing Commission staff to immediately begin work on a draft Order Instituting Rulemaking (OIR) that will examine and propose appropriate modifications to the SRAC methodology."

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<sup>1</sup> The Topock index is based on deliveries at the Arizona/California border, and the Malin index is based on deliveries at the Oregon/California border.

(D.03-12-062, as modified by D.04-07-037, p. 24 (slip op).) Edison sought review of D.03-12-067, as well as D.04-01-050, on the grounds that the Section 390 formula did not comply with PURPA. In *Southern California Edison Co. v. Public Utilities Comm.* (2005) \_\_\_\_ Cal. App. 4<sup>th</sup> \_\_\_\_, the Second Appellate District upheld the Commission's decisions. The Court noted that review of the SRAC Formula was currently proceeding in rulemaking (R.) 04-04-025, *Order Instituting Rulemaking to Promote Consistency in Methodology and Input Assumptions in Commission Applications of Short-run and Long-run Avoided Costs, including Pricing for Qualifying Facilities*. Further, the Court determined that Edison had failed to provide evidence that SRAC prices under the SRAC Formula exceeded its avoided costs.

### **LEGISLATIVE HISTORY:**

SB 173 (Dunn) was proposed in 2003. This bill would have added section 391.1 to the Public Utilities Code. Section 391.1 would have allowed the Commission to determine whether any gas price index used in the Section 390 formula was "verified and reliable." In the event that the Commission determined that the gas price indices were not "reliable and verified," section 391.1 would have allowed the Commission to establish and update SRAC prices in a manner that was consistent with PURPA. This bill did not get out of the Committee. The bill was opposed by the QF's, PG&E and large oil companies.

### **FISCAL IMPACT:**

Unknown

### **STATUS:**

SB 1833 was heard in the Senate Energy, Utilities and Communications Committee on April 4, 2006. The bill passed out of the Committee. However, it was stripped of the original language and intent language will be inserted instead. SB 1833 will next be heard in the Senate Appropriations Committee.

### **SUPPORT/OPPOSITION:**

#### **Support**

Pacific Gas & Electric  
Southern California Edison  
Division of Ratepayer Advocates  
The Utility Reform Network

#### **Oppose**

Caithness Energy  
California Biomass Energy Alliance  
California Forestry Association  
California Wind Energy Association  
Collins Pine Company  
Colmac Energy, Inc.  
Constellation Energy  
Covanta Energy Group, Inc.  
GWP Power Systems  
HL Power Company  
Rio Bravo Fresno  
Rio Bravo Jasmin  
Rio Bravo Poso  
Rio Bravo Rocklin  
Sanitation Districts of Los Angeles County  
Wadham Energy LP  
Waste Management Inc.  
Western States Petroleum Association  
Wheelabrator Shasta Energy

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**BILL LANGUAGE:**

BILL NUMBER: SB 1833     INTRODUCED  
BILL TEXT

INTRODUCED BY     Senator Kehoe

FEBRUARY 24, 2006

An act to repeal Section 390 of the Public Utilities Code,  
relating to electrical restructuring.

LEGISLATIVE COUNSEL'S DIGEST

SB 1833, as introduced, Kehoe     Electrical restructuring: energy prices paid to nonutility generators.

Under existing law, the Public Utilities Commission has regulatory authority over public utilities, including electrical corporations. The existing restructuring of the electrical industry within the Public Utilities Act provides for the establishment of an independent Power Exchange as a nonprofit public benefit corporation. Existing law, enacted as part of restructuring, prescribes how energy prices paid to nonutility power generators (qualifying facilities) by an electrical corporation based on the commission's "short run avoided cost energy methodology" are to be determined, subject to applicable contractual terms. One of the existing determinants of the price to be paid by electrical corporations to qualifying facilities is the clearing price paid by the Power Exchange. Until this determinant is satisfied, existing law requires the commission to base short run avoided cost energy payments paid to qualifying facilities on a formula that reflects a starting energy price, adjusted monthly to reflect changes in a starting gas index price in relation to an average of current California natural gas border price indices.

This bill would repeal the above-described requirements for how the commission is to determine the energy prices paid to qualifying facilities by an electrical corporation.

Vote: majority. Appropriation: no. Fiscal committee: yes.  
State-mandated local program: no.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1.     Section 390 of the Public Utilities Code is repealed.

~~— 390. — (a) Subject to applicable contractual terms, energy prices paid to nonutility power generators by a public utility electrical corporation based upon the commission's prescribed "short run avoided cost energy methodology" shall be determined as set forth in subdivisions (b) and (c).~~

~~— (b) Until the requirements of subdivision (c) have been satisfied, short run avoided cost energy payments paid to nonutility power~~

~~generators by an electrical corporation shall be based on a formula that reflects a starting energy price, adjusted monthly to reflect changes in a starting gas index price in relation to an average of current California natural gas border price indices. The starting energy price shall be based on 12 month averages of recent, pre January 1, 1996, short run avoided energy prices paid by each public utility electrical corporation to nonutility power generators. The starting gas index price shall be established as an average of index gas prices for the same annual periods.~~

~~—(c) The short run avoided cost energy payments paid to nonutility power generators by electrical corporations shall be based on the clearing price paid by the independent Power Exchange if (1) the commission has issued an order determining that the independent Power Exchange is functioning properly for the purposes of determining the short run avoided cost energy payments to be made to nonutility power generators, and either (2) the fossil fired generation units owned, directly or indirectly, by the public utility electrical corporation are authorized to charge market based rates and the "going forward" costs of those units are being recovered solely through the clearing prices paid by the independent Power Exchange or from contracts with the Independent System Operator, whether those contracts are market based or based on operating costs for particular utility owned powerplant units and at particular times when reactive power/voltage support is not yet procurable at market based rates at locations where it is needed, and are not being recovered directly or indirectly through any other source, or (3) the public utility electrical corporation has divested 90 percent of its gas fired generation facilities that were operated to meet load in 1994 and 1995. However, nonutility power generators subject to this section may, upon appropriate notice to the public utility electrical corporation, exercise a one time option to elect to thereafter receive energy payments based upon the clearing price from the independent Power Exchange.~~

~~—(d) If a nonutility power generator is being paid short run avoided costs energy payments by an electrical corporation by a firm capacity contract, a forecast as available capacity contract, or a forecast as delivered capacity contract on the basis of the clearing price paid by the independent Power Exchange as described in subdivision (c) above, the value of capacity in the clearing price, if any, shall not be paid to the nonutility power generator. The value of capacity in the clearing price, if any, equals the difference between the market clearing customer demand bid at the level of generation dispatched by the independent Power Exchange and the highest supplier bid dispatched.~~

~~—(e) Short run avoided energy cost payments made pursuant to this section are in addition to contractually specified capacity payments. Nothing in this section shall be construed to affect, modify or amend the terms and conditions of existing nonutility power generators' contracts with respect to the sale of energy or capacity or otherwise.~~

~~—(f) Nothing in this section shall be construed to limit the level of transition cost recovery provided to utilities under electric industry restructuring policies established by the commission.~~

~~—(g) The term "going forward costs" shall include, but not be limited to, all costs associated with fuel transportation and fuel supply, administrative and general, and operation and maintenance, provided that, for purposes of this section, the following shall not~~

~~be considered "going forward costs": (1) commission approved capital costs for capital additions to fossil fueled powerplants, provided that such additions are necessary for the continued operation of the powerplants utilized to meet load and such additions are not undertaken primarily to expand, repower or enhance the efficiency of plant operations; or, (2) commission approved operating costs for particular utility owned powerplant units and at particular times when reactive power/voltage support is not yet procurable at market based rates in locations where it is needed, provided that the recovery shall end on December 31, 2001.~~